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Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 CIEP-01 SP-02 STR-04 TRSE-00
LAB-04 SIL-01 OMB-01 PA-01 PRS-01 USIA-06 /058 W
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R 071609Z FEB 77
FM USMISSION EC BRUSSELS
TO SECSTATE WASHDC 2950
INFO AMEMBASSY DUBLIN

C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 01176

E.O. 11652: GDS
TAGS: EFIN, EEC, EI
SUBJECT: EC MONETARY COMMITTEE DOCUMENT ON IRELAND

REF: (A) FEBRUARY 4 WARNE/GELBARD TELCON, (B) EC BRUSSELS 1035

1. AS REQUESTED REFERENCED TELECON, FOLLOWING IS REPORT TO EC MONETARY COMMITTEE ON ECONOMIC SITUATION IN ORELAND REFERRED TO IN REF B. USG POSSESSION OF THIS DOCUMENT SHOULD NOT BE REVEALED.

2. BEGIN QUOTE:
(1) AT ITS MEETING OF 19 OCTOBER 1976, THE MONETARY COMMITTEE REQUESTED ITS AD HOC WORKING PARTY "IRELAND" CHAIRED BY MR. ANDERSEN TO EXAMINE THE ECONOMIC SITUATION IN IRELAND IN 1976, AND THE PROSPECTS FOR 1977 AND REPORT ON THE EXTENT TO WHICH THE ECONOMIC POLICY CONDITIONS LAID DOWN IN THE COUNCIL DECISION OF 15 MARCH 1976 HAVE BEEN RESPECTED IN 1976. THE WORKING PARTY MET ON 15 DECEMBER 1976 IN COPENHAGEN AND HEREBY SUBMITS ITS CONCLUSIONS.

THE ECONOMIC SITUATION IN 1976
(2) DURING THE FIRST HALF OF 1976, ACTIVITY IN THE IRISH ECONOMY WAS FAIRLY BOUYANT, ALTHOUGH THERE ARE SIGNS
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THAT THE RATE OF EXPANSION IN THE SECOND HALF OF THE YEAR WILL BE SOMEWHAT LOWER, GIVING AN OVERALL GROWTH RATE OF REAL GNP OF AROUND 3.5 PERCENT FOR THE YEAR AS A WHOLE.
(3) OUTPUT OF MANUFACTURING INDUSTRY IN THE FIRST HALF OF THE YEAR ROSE BY OVER 8 PERCENT COMPARED WITH THE SAME PERIOD LAST YEAR, AND IT IS ESTIMATED THAT THE MANUFACTURING SECTOR WAS,DURING THE SAME PERIOD, WORKING AT ABOUT 85 PERCENT

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OF OPERATING CAPACITY. ACTIVITY IN BUILDING AND THE
SERVICES SECTOR WAS ALSO HIGHER THAN IN 1975. IN AGRI-
CULTURE, WHICH REPRESENTS A SIGNIFICANT PART OF THE
ECONOMY, IT IS EXPECTED THAT THERE WILL BE SOME DECLINE
IN NET OUTPUT IN 1976.
(4) THE INVESTMENT SITUATION HAS IMPROVED IN RECENT
MONTHS. IMPORTS OF PRODUCERS' CAPITAL GOODS HAVE RISEN
SHARPLY SINCE MID-YEAR AND PRIVATE NON-HOUSING INVESTMENT
HAS ALSO BEEN STRONG.
(5) CONSUMER DEMAND HAS BEEN FIARLY BOUYANT THROUGHOUT
THE YEAR, DEPITE A SETBACK DURING THE SUMMER AS A RESULT
OF THE BANK STRKE. EVEN SO, RETAIL SALES INCREASED BY
4 PERCENT IN VOLUME IN THE FIRST NINE MONTHS OF THE YEAR IN
COMPARISION WITH THE SAME PERIOD LAST YEAR.
(6) WHILE THE LEVEL OF EMPLOYMENT IMPROVED SLIGHTLY,
THE LEVEL OF UNEMPLOYMENT IS STILL HIGH AND WAS ABOUT
9 1/2 PERCENT OF ACTIVE POPULATION IN NOVEMBER. HOWEVER,
SEASONALLY ADJUSTED FIGURES FOR RECENT MONTHS SHOW AN
IMPROVEMENT IN THE UNDERLYING TREND.
(7) THE TREND IN CONSUMER PRICES REMAINS WORRYING;
DESPITE A SLOWDOWN IN THE THIRD QUARTER OF 1976, THERE
WAS A FURTHER SURGE IN THE FOURTH QUARTER, PARTLY AS A
RESULT OF THE DOWNWARD DRIFT OF THE POUND, INCLUDING THE
SOMEWHAT SMALLER ADJUSTMENT TO THE GREEN POUND. THE
AVERAGE RATE OF INFLATION WAS 18 PERCENT FOR THE YEAR AS A
WHOLE.
(8) ON THE SIDE OF FOREIGN TRADE, MERCHANDISE EXPORTS
HAVE INCREASED SIGNIFICANTLY. FOR THE FIRST ELEVEN MONTHS
OF THE YEAR THEY ROSE BY 27 PERCENT IN VALUE TERMS OVER THE SAME
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PERIOD IN 1975. INDUSTRIAL EXPORTS HAVE DONE PARTICULARLY
WELL, INCREASING BY 39 PERCENT IN VALUE, REFLECTING LARGE SALES
TO NON-EEC COUNTRIES, PARTICULARLY JAPAN AND THE OIL
EXPORTING COUNTRIES AS WELL AS A BETTER PERFORMANCE ON
MARKETS OTHER THAN THE UK AS A RESULT OF THE DEPRECIATION
OF THE POUND. (THIS DEPRECIATION HAS IT ITSELF, OF COURSE,
TENDED TO INFLATE THE VALUE OF EXPORTS EXPRESSED IN
DOMESTIC CURRENCY). AGRICULTURAL EXPORTS SHOWED A
VOLUME DECLINE FOR THE YEAR AS A WHOLE.
(9) THE VALUE OF MERCHANDISE IMPORTS DURING THE FIRST
ELEVEN MONTHS OF 1976 INCREASED BY 38 PERCENT OVER THE SAME
PERIOD IN 1975 ON ACCOUNT OF THE DEPARECIATION OF THE
POUND COMBINED WITH INCREASING PURCHASES OF RAW MATERIALS,
SEMI-FINISHED GOODS AND PRODUCERS' CAPITAL GOODS. AS
EXPECTED, WITH THE REVIVAL OF ECONOMIC ACTIVITY, THERE
HAS BEEN A DETERIORATION, IN THE CURRENT BALANCE, WHICH
ES EXPECTED TO SHOW A DEFICIT OF 160 MILLION POUNDS FOR THE
YEAR AS A WHOLE (15 MILLION POUNDS IN 1975).

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PROSPECTS FOR 1977

(10) A NUMBER OF FACTORS COMBINE TO MAKE THE PROSPECTS FOR 1977 RATHER UNCERTAIN AT THE PRESENT TIME. FOREMOST AMONG THESE ARE THE DEVELOPMENT OF DOMESTIC INCOMES, THE RATE OF GROWTH OF WORLD TRADE AND THE FUTURE PRICE OF OIL.
(11) THE RATE OF GROWTH OF REAL GNP IS LIKELY TO BE SLIGHTLY LOWER THAN THAT IN 1976, AT AROUND 2 TO 3 PERCENT. THIS IMPLIES A RATE OF ACTIVITY WHICH WOULD STILL REMAIN BELOW PRODUCTIVE CAPACITY, AND THEREFORE DOES NOT PRESAGE ANY MAJOR FALL IN THE LEVEL OF UNEMPLOYMENT, PARTICULARLY GIVEN THE EXPANSION OF THE ACTIVE POPULATION, THE SHIFT FROM AGRICULTURAL TO INDUSTRIAL WORK AND THE PROGRESSIVE REDUCTION OF FOREIGN INVESTMENT DURING RECENT YEARS.

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(12) THE SLOWER RATE OF GROWTH WILL BE MAINLY DUE TO A DECLINE IN THE RATE OF EXPANSION OF DOMESTIC DEMAND CONCENTRATED ON THE SIDE OF CONSUMPTION. THIS ASSUMES THAT THE PRESENT GOVERNMENT PROGRAMME OF INCOMES RESTRAINT WILL BE SUCCESSFUL, THUS LEADING TO SOME DECLINE IN REAL INCOMES.
(13) TRENDS IN THE RATE OF INFLATION WILL BE HIGHLY DEPENDENT ON THE SUCCESS OF THE INCOMES RESTRAINT POLICY, BUT WILL ABO DENAFFECTED BY THE INCREASE IN IMPORT PRICES. IF THE POUND SHOULD DEPRECIATE FURTHER, THIS INCREASE IN IMPORT PRICES WILL BE AGGRAVATED. ALTHOUGH THE RATE OF INFLATION WILL STILL BE ABOVE THE AVERAGE FOR THE COMMUNITY AS A WHOLE, A REDUCTION TO AROUND 13 PERCENT IS EXPECTED.

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(14) PROVIDED THE PRESENT RATE OF EXPANSION OF WORLD TRADE (7 PERCENT) IS MAINTAINED, THE PROSPECTS FOR IRISH EXPORTS REMAIN FAVOURABLE, AND ANY INCREASES IN OUTPUT WILL BE CONCENTRATED IN THE EXPORT SECTOR. AGRICULTURAL EXPORTS ARE ALSO EXPECTED TO INCREASE.
(15) IMPORTS SHOULD GROW AT A SLOWER RATE IN LINE WITH THE LOWER RATE OF EXPANSION OF DEMAND AND PRODUCTION, BUT GIVEN THE DETERIORATION IN THE TERMS OF TRADE THE CURRENT DEFICIT IS EXPECTED TO RAMIN HIGH AT AROUND
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200 MILLION POUNDS IN 1977.

RESPECT OF THE ECONOMIC POLICY CONDITIONS

(16) (A) "GROWTH IN THE CENTRAL GOVERNMENT BORROWING REQUIREMENT EXPRESSED AS A PERCENTAGE OF GNP SHOULD BE HALTED IN 1976 AND SHOULD BE REDUCED IN SUBSEQUENT YEARS."
IN 1975, THE ACTUAL BORROWING REQUIREMENT WAS 601 MILLION POUNDS EQUAL TO 16.9 PERCENT OF GNP. THE BUDGETED BORROWING REQUIREMENT FOR 1976 WAS 679 MILLION POUNDS, OR 15.8 PERCENT OF GNP. THE OUTTURN IS NOW PROVISIONALLY ESTIMATED TO BE 505 MILLION POUNDS OR 11.5 PERCENT OF ESTIMATED 1976 GNP.
THIS IMPORTANT REDUCTION IN THE BORROWING REQUIREMENT IS DUE TO A MARKED IMPROVEMENT IN TAX RECEIPTS REFLECTING HIGHER ECONOMIC ACTIVITY, TO A STRICT CONTROL OF EXPENDITURE IN THE COURSE OF THE YEAR AND TO SOME INCREASE IN EXCISE DUTIES; HOWEVER, IT WAS ALSO MADE POSSIBLE BY EXCEPTIONAL NON-RECURRENT FACTORS SUCH AS SAVINGS ON THE PUBLIC CAPITAL PROGRAMME AND ON DEBT SERVICE CHARGES AND TO THE SWITCHING OF CIVIL SERVANTS ON TO A PAYE INCOME TAX SYSTEM.
THE WORKING PARTY CONSIDERS THAT IT WOULD BE DESIRABLE IF THE MOVEMENT TOWARDS THE REDUCTION OF THE BORROWING REQUIREMENT IN TERMS OF GNP WERE CONTINUED IN 1977 TO BRING IT BELOW THE LEVEL REACHED IN 1976, PERHAPS WITH SOME ALLOWANCE FOR THE NON-RECURRING FACTORS REFERRED TO ABOVE. IT IS AWARE, HOWEVER, THAT A SUCCESSFUL DRIVE TO CHECK INFLATION AND TO STABILIZE THE IRISH ECONOMY HINGES, TO A GREAT EXTENT, ON THE OUTCOME OF THE POLICY OF INCOME MODERATION PURSUED BY THE GOVERNMENT. IN ORDER TO OBTAIN GENERAL ACCEPTANCE OF A SIGNIFICANT EFFORT OF INCOME RESTRAINT CERTAIN CONCESSIONS MAY HAVE TO BE ACCEPTED IN THE BUDGET IN THE FORM OF AN ACCOMODATING TAX POLICY. IN ANY EVENT,
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THE WORKINGPARTY CONSIDERS THWT ANY RELAXATPON IN THE
CONSTRAINTS APPLIED TO THE BORROWING REQUIREMENT WOULD
AUTOMATICALLY LEND ADDED IMPORTANCE TO A MORE RIGOROUS
PURSUIT OF MONETARY POLICY AND OF NON-MONETARY FINANCING
OF THE PUBLIC SECTOR DEFICIT.
(17) (B) "EVERY EFFORT SHALL BE MADE TO FINANCE THE
LARGEST POSSIBLE PROPORTION OF PUBLIC SECTOR BORROWING
REQUIREMENT BY NON-MONETARY MEANS, SUCH AS BY PLACING
LONG-TERM SECURITIES DIRECTLY WITH THE PUBLIC."
DESPITE VERY DIFFICULT CONDITIONS ON THE DOMESTIC
MONEY MARKET DUE TO THE BANK STRIKE AND THE INFLUENCE OF
EXTENAL DEVELOPMENTS, SOME 190 MILLION POUNDS HAS BEEN
RAISED BY SALES OF GOVERNMENT STOCK TO THE PUBLIC AND
THROUGH GOVERNMENT SAVINGS SCHEMES. THE IRISH AUTORITIES
WILL MAINTAIN THEIR EFFORTS TO IMPROVE NON-MONETARY
FINANCING OF THE DEFICIT IN 1977, BUT FEAR THAT MARKET
DEVELOPMENTS WILL MAKE IT DIFFICULT TO SELL THE SAME
AMOUNT OF GOVERNMENT STOCK TO THE PUBLIC AS IN 1976
(PROVISIONALLY ESTIMATED AT 135 MILLION POUNDS). THE
WORKING PARTY RECOMMENDS NEVERTHELESS THAT THE IRISH
AUTHORITIES DO THEIR UTMOST TO LIMIT THE MONETARY
FINANCING OF THE DEFICIT.
(18) (C) "THE IRISH AUTORITIES SHALL EXERCISE THE
UTMOST CAUTION TO AVOID ANY RELAXATION OF ITS MONETARY
POLICY FOR THE PURPOSE OF MEETING BOTH THE BORROWING
REQUIREMENT OF THE XCHEQUER AND THE DEMAND FOR CREDIT
IN THE PRIVATE SECTOR, WERE THE LATTER TO EXPAND MORE
RAPIDLY THAN AT PRESENT FORESEEN."
WHEN MONETARY POLICY FOR 1976 WAS BEING FORMULATED
IT WAS PROJECTED THAT THE FINANCING OF BOTH THE PRIVATE
AND PUBLIC SECTOR DEMANDS FOR CREDIT WOULD LEAD TO AN
INCREASE IN THE WIDE MONEY SUPPLY IN 1976 OF THE ORDER
OF 24 PERCENT. IT IS NOW CLEAR THAT THE OUTCOME WAS CONSIDERABLY
LESS THAN ANTICIPATED. THERE WAS A RAPID INCREASE IN
HPRIVATE SECTOR CREDIT OF SOME 25 PERCENT (OR SUBSTANTIALLY MORE
THAN WAS ORIGINALLY ENVISAGED), BUT MONETARY FINANCING
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OF THE EXCHEQUER, WHILE STILL SUBSTANTIAL, WAS MUCH
SMALLER THAN EXPECTED. ALTHOUGH FULL BANKING DATA FOR
THE YEAR ARE NOT YET AVAILABLE, THE INCREASE IN THE MONEY
SUPPLY FOR 1976 APPEARS TO HAVE BEEN OF THE ORDER OF 16 PERCENT.
IN 1977, THE WORKING PARTY CONSIDERS THAT EXPANSION
OF MONEY SUPPLY SHOULD BE KEPT WITHIN AN OVERALL LIMIT
OF ABOUT 17-17 PERCENT, A LEVEL WHICH WOULD BE SLIGHTLY ON
THE OWER SIDE OF THE EXPECTED GROWTH OF GNP IN
NOMINAL TERMS. END QUOTE. HINTON

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Decaption Note:
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Disposition Approved on Date:
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